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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

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In the Matter of )  
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Simplification of the )  
Depreciation Prescription Process )

CC Docket No. 92-296

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

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Petition for Reconsideration

of

The Southern New England Telephone Company

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The Southern New England Telephone Company (SNET), pursuant to Section 1.429 of the Rules (47 C.F.R. §1.429) of the Federal Communications Commission (Commission), hereby petitions for reconsideration of the Report and Order adopted September 23, 1993 and released October 20, 1993 in the above captioned proceeding.<sup>1</sup>

I. Introduction.

The Commission in the R&O did not adopt the "price cap carrier" option proposed in the Notice of Proposed Rulemaking,<sup>2</sup> in spite of a substantial record supporting the option, but instead adopted the "basic factor range" option.

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<sup>1</sup> Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, Report and Order released October 20, 1993, FCC 93-452 (R&O).

<sup>2</sup> Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, Notice of Proposed Rulemaking released December 29, 1992, FCC 92-296, 8 FCC Rcd 146 (1993), paras. 40-43.

The Commission's principle reasoning behind this action -- that "the competitiveness of the LECs' markets overall are not sufficiently robust to warrant any additional flexibility"<sup>3</sup> -- disregards what is in fact a dynamic and competitive telecommunications market. Subsequent to the filing of comments and replies, and, indeed, even since the R&O was adopted, the telecommunications environment has literally exploded into a frenzy of competitive activity which is directly affecting all local exchange carriers (LECs), and their access and local service customers.

The second rationale given -- that LECs may manipulate earnings with the price cap carrier option<sup>4</sup> -- is likewise unsupported. In fact, LECs are motivated *not* to manipulate earnings, as the safeguards against, and the penalties for, such action are very strong.

SNET petitions the Commission to recognize the effects of rapid changes in technology and competition on the equipment lives of LECs' properties. The Commission should adopt the price cap carrier option on reconsideration, to provide the LECs with the flexibility and simplification necessary to be responsive to these changes in a manner that is responsive to the changing environment and is in the public interest.

## II. The Price Cap Carrier Option Should Be Adopted.

### A. Competition In LEC Markets Is Robust.

The Commission did not adopt the price cap carrier option, but rather adopted the basic factor range option, stating that the LECs' "competitive pressures are not such that we can rely on them to provide an adequate check on LECs' depreciation choices."<sup>5</sup>

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<sup>3</sup> R&O, para. 28.

<sup>4</sup> R&O, para. 45.

<sup>5</sup> Id. See also R&O, paras. 42, 44, 45.

This statement reveals a serious underestimation of the competitive pressures on the LECs. It is ironic that the Commission has gone to great lengths over a significant period of time to bring the benefits of competition to the marketplace, yet it minimizes the impact of that competition upon the local carriers against whom the competition is encouraged.

The heightened levels of competition are more evident every day.<sup>6</sup> The pending mergers of some regional Bell holding companies with cable television companies, for example, are producing large telecommunications carriers with facilities over the whole country that will be competing directly with other LECs' services. "While most publicity about the recent mergers has focused on the offering of futuristic services, it is the huge \$100 billion market for basic phone service that is most ripe for plundering. ... [M]any local telephone companies are in for a competitive shock that could rival what [AT&T] endured in the long distance market a decade ago."<sup>7</sup> It is not necessary for many precisely identical services to be available to consumers for robust competition with LECs to exist. Access, for example, can be provided in many different ways compared to traditional copper wires from telephone company switching centers to consumers' premises.<sup>8</sup>

Cable companies are among the prime competitors with telephone companies, because of their wide-spread distribution facilities and advancing technologies. "Five of the largest cable companies ... said today that they would

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<sup>6</sup> Recent filings with the Commission in a number of proceedings attest to the indisputable realities of competition with and among LECs. In particular, the Reply Comments of Southwestern Bell Telephone Company in Rulemaking #8356 (Reform of the Interstate Access Charge Rules) filed November 16, 1993 are relevant: "LECs face competitive challenges from [competitive access providers (CAPs) and] a number of other fronts, made possible by the convergence of telephony and computer technologies." Southwestern Bell Reply Comments, Appendix 1, pg. 4. Competition is provided by cable television networks, cellular providers, the personal communications services, private networks, interexchange carriers, and resellers. *Id.*, pgs. 2-12.

<sup>7</sup> Edmund L. Andrews, "From Sibling Rivalry to Civil War," The New York Times, November 28, 1993 (Andrews), Section 3, pg. 1.

<sup>8</sup> For example, MCI and Jones Lightwave, Inc. have announced plans to provide services which "will allow consumers to use their cable television wire for long distance calling [and] bypass the ... local phone company to make long distance calls." "Cable-TV Calls to Face Test," The New York Times, November 23, 1993, page D-6.

develop a variety of new local telecommunications services with the help of Teleport Communications Group, a fiber optics company ... that provides local service in competition with phone companies in many of the largest metropolitan markets."<sup>9</sup> The competitive force of these combined market, technological and facilities-based partners is formidable:

[A]lliances between telephone and cable television companies are rapidly transforming the telecommunications industry and promise to both increase the number of lines to be filled and intensify the competition for customers.... A growing list of alliances between telephone and cable television companies also means that many consumers will eventually be able to place telephone calls over the cable television line coming into their home.<sup>10</sup>

In addition, personal communications service (PCS) is becoming a market reality. SNET and every other LEC will be facing up to seven new competitive communications providers in their service areas. "Many PCS applications have the potential to create new markets and to provide competition in others for the first time. PCS also will raise the overall level of competition in many already competitive segments of the telecommunications industry."<sup>11</sup>

All these new telecommunications service providers possess features and facilities that will cause the equipment lives of LEC embedded technologies, such as analog switching and wireline facilities, to be shortened. Dynamic competitive market pressures simply result in loss of service value to some existing properties. The slow growth of LECs' local services (about 2%-3% per year), compared to the higher growth of interstate services (about 10%-12% per year), requires the LECs to move now in response to any competition. LECs have no cushion of growth to

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<sup>9</sup> John Markoff, "Cable Companies in Venture To Rival Phone Companies," The New York Times, December 2, 1993, pg. D1.

<sup>10</sup> Anthony Ramirez, "Battle Is Fierce on the Phone Front," The New York Times, November 27, 1993, pg. 35.

<sup>11</sup> Amendment of the Commission's Rules to Establish New Personal Communications Services, GEN Docket No. 90-314, RM-7140, RM-7175, RM-7618, Second Report and Order released October 22, 1993, FCC 93-451, para. 2.

develop their facilities, and have to move rapidly to deploy advanced technologies in response to low cost, high productivity providers that selectively serve customers who can be highly profitable. The LECs' competitors have no regulatory constraints on pricing, costing, filing requirements, depreciation rates, facilities construction, reporting, monitoring, accounting, rate base definition, or earnings limitations. LECs must have the flexibility to move their depreciation rates into line with all telecommunications providers, if the industry is to become technologically developed and fully competitive.

SNET welcomes competition. But along with competition, all LECs must be able to compete on an equal footing with their competitors. The stakes are high. "Many telephone companies have a lot to lose. ...the most profitable chunk of telephone business is the easiest to snatch away [because] what makes these 'access charges' easy to plunder is that they are highly inflated, in part because they allow state regulators to subsidize low prices for basic phone service."<sup>12</sup> Indeed, in the interstate access arena, SNET has already responded to competition with net price reductions totaling \$29.67 million since electing price cap regulation effective July 1, 1991.

Competition in the State of Connecticut has been growing for years, and is now a full-fledged reality as the result of the Department of Public Utility Control's (Department's) recent decision.<sup>13</sup> In addition, the Connecticut State Legislature's Energy and Public Utility Committee's Telecommunications Task Force is developing revisions to current laws which, if enacted, would permit expanded competition into nearly all aspects of telecommunications services, including local service.<sup>14</sup>

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<sup>12</sup> Andrews, pg. 6.

<sup>13</sup> "The intent of the Department in this proceeding is to ensure an orderly transition to a fully competitive marketplace (for both interexchange and intraexchange services), ... represent[ing] a central, final and irrevocable commitment by this Department to bringing the benefits of increased choice to residential and business customers in Connecticut." DPUC Review of Telecommunications Policies: Infrastructure Modernization, Competition, Pricing Principles and Methods of Regulation, Docket No. 91-10-06, Decision, July 7, 1993, pg. 49.

<sup>14</sup> Connecticut Public Act No. 93-330, effective July 1, 1993.

SNET believes that competition cannot be mandated at the state level, and also disregarded at the federal level, because the same depreciable facilities are used for both jurisdiction's services.

SNET urges the Commission to recognize the dynamic telecommunications marketplace in which the LECs operate, a marketplace it has long fostered, but in fact requires immediate additional regulatory attention.<sup>15</sup> The Commission cannot just look at the narrow range of interstate access tariffed services to form opinions regarding the competitiveness of the LECs' markets overall; the Commission should look at the myriad of telecommunications providers, products and services that will provide opportunities for all carriers and consumers to meet their telecommunications needs with LEC and non-LEC services.

B. Carriers Are Motivated *Not* To Manipulate Price Cap Earnings With Depreciation Rate Changes.

The Commission has stated that it will not adopt the price cap carrier option because it would "create[ ] a significant opportunity and incentive for LECs to undermine the sharing component."<sup>16</sup>

In fact the opposite is true. If a LEC actually manipulated earnings by adjusting depreciation rates, it would in fact create more serious business problems, in that any artificial over-statement of depreciation expenses now would actually

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<sup>15</sup> The recent spate of proceedings at the Commission is evidence that the robustly competitive telecommunications environment requires immediate and progressive regulatory action. For example: (1) Petition of MFS Communications Company filed November 1, 1993 to develop new policies for preserving universal service in the new telecommunications market, RM 8388; (2) Petition of the United States Telephone Association filed September 17, 1993 for reform of the interstate access charge rules to reflect rapid technological changes, evolving customer needs, increased access market competition, and pro-competitive Commission policies, RM 8356; (3) FCC News Release of August 3, 1993 inviting public discussion of the Common Carrier Bureau's Staff Working Paper on Access Charge Reform from the Federal Perspective, based on rapid development of new technologies the growth in competition for long distance and access services, (undocketed); (4) FCC Public Notice establishing pleading cycle on the National Association of Regulatory Commissioners' Petition for Notice of Inquiry into the issues raised by the Access Issues Work Group that the very nature of access is changing due to technology, regulation and competition (DA 93-847).

<sup>16</sup> R&O, para. 42.

force potentially higher sharing later, because the price cap rate base would eventually be understated. And any artificial under-statement of depreciation expenses now could produce future losses, because under-recovered plant would be subject to reserve imbalances and write-offs.<sup>17</sup> These risks and economic penalties far outweigh any incentive to manipulate or avoid sharing, assuming such manipulation could be done without detection in the first place. The Commission pays scant heed to this major safeguard,<sup>18</sup> yet it acknowledges that true oversight is provided by the marketplace.<sup>19</sup>

The Commission further states that its own safeguards, the additional safeguards proposed by the LECs, and the safeguards provided by the market itself, are not enough to save the price cap carrier option.<sup>20</sup> But in fact, 47 C.F.R. itself is a full set of safeguards; all safeguards act *together* -- not "individually"<sup>21</sup> -- to protect consumers. Aside from the simple fact that purposeful misrepresentation of depreciation expense would be unethical, the Communications Act provides for imprisonment or fines for those who willingly make false entries in any book of accounts.<sup>22</sup> The Commission cannot dismiss all these effective and time-tested protections as only "providing some minimal limitation on earnings management."<sup>23</sup>

Further, no party in this proceeding has actually stated just how a LEC might adjust its depreciation rates in any practical way under this option to accomplish

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<sup>17</sup> See, SNET Comments of March 10, 1993, pgs. 8-12. This is not to say that any manipulation of earnings to avoid sharing would not be a serious problem.

<sup>18</sup> R&O, para. 45.

<sup>19</sup> "[A]s carriers face increasing competitive pressures, they should have less incentive to seek depreciation rates that are not in line with company operations." R&O, para. 21.

<sup>20</sup> R&O, paras. 45-48.

<sup>21</sup> R&O, para. 48.

<sup>22</sup> 47 U.S.C. § 220(e). See also 47 C.F.R. § 32.4.

<sup>23</sup> R&O, para. 45.

the purported objective of manipulation.<sup>24</sup> SNET submits that the concern with potential manipulation is a red herring proposed by other parties, a diversion to avoid adoption of the price cap carrier option, in spite of the fact that depreciation expense has again been affirmed to be endogenous.<sup>25</sup> The price cap form of regulation in and of itself protects consumers from unwarranted price changes, a regulatory approach in which the Commission is firmly grounded. Yet, here is a cost which is endogenous by definition. Not adopting the price cap carrier option undermines this basic reality that it is the technological and competitive environment, not a specific earnings target, causes the actual "loss in service value ... during the service life of the property."<sup>26</sup>

SNET urges the Commission to conclude that the LECs are motivated not to manipulate price cap earnings with depreciation rate changes, and that, even if they were, there is no practical way to accomplish such manipulation without detection.

### III. The Basic Factors Range Option Should Be Revised Further.

The Commission has adopted a modified basic factors range option as the way it will implement simplification to meet "the three goals of simplification, administrative cost savings, and flexibility."<sup>27</sup> While the Commission's goals and principles are appropriate, the basic factor range option does not achieve them nearly as well as the price cap carrier option would.

Without prejudice to its strong belief that the Commission should adopt the price cap carrier option on reconsideration, SNET supports the Petition for Reconsideration filed today in this proceeding by The United States Telephone Association (USTA). As USTA describes, the detailed rules and conditions

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<sup>24</sup> SNET notes that in order to decrease its price cap rate of return by one percentage point, it would have to increase its annual interstate depreciation expense by \$9 million or 12%, a change which is not likely to escape detection.

<sup>25</sup> R&O, para. 83.

<sup>26</sup> 47 C.F.R. §32.2000(g)(1)(i).

<sup>27</sup> R&O, para. 23.


promulgating the basic factor range option are very cumbersome, and provide little flexibility to the LECs in responding to the pressures of technological advancement and competition in the industry. USTA recommends several detailed changes to the modified basic factors range option; SNET supports these modifications, should the Commission not adopt the price cap carrier option on reconsideration.

IV. Conclusion.

The Commission can no longer disregard the reality of robust competition in the LEC telecommunications markets, which is adversely affecting the equipment lives of the LECs' properties. SNET strongly recommends that the Commission adopt the price cap carrier option on reconsideration, to provide the depreciation prescription flexibility and simplification requisite to the new environment.

Respectfully submitted,

The Southern New England Telephone Company

by: \_\_\_\_\_

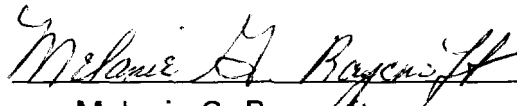
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December 6, 1993

Certificate of Service

I, Melanie G. Raycroft, hereby certify that the foregoing "Petition for Reconsideration of The Southern New England Telephone Company" in CC Docket No. 92-296 was served this day, by United States mail, first class postage prepaid, to the parties of record in this proceeding.

  
Melanie G. Raycroft

December 6, 1993